

DOCUMENT RESUME

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[Use of Farmers Home Administration Financed Rural Rental Housing for Commercial Office Space]. B-171630. March 1', 1977. Released May 5, 1977. 3 pp. + enclosure.

Report to Rep. Les Aspin; by Robert F. Keller, Acting Comptroller General.

Issue Area: Domestic Housing and Community Development: Management of Federal Housing Programs (2105).

Contact: Community and Economic Development Div.

Budget Function: Income Security: Public Assistance and Other Income Supplements (604).

Organization Concerned: Department of Agriculture; Farmers Home Administration; Waltra Corp., Nazomanie, WI; Wick Homes, Inc., Nazomanie, WI.

Congressional Relevance: Rep. Les Aspin.

Authority: Housing Act of 1949, as amended.

A review was conducted to determine the legality and propriety of a decision by Farmers Home Administration, Department of Agriculture, to permit the Waltra Corporation to convert two buildings into office space and into apartment units for senior citizens and families of low and moderate incomes. Findings/Conclusions: The loan agreements between Farmers Home Administration and Waltra Corporation did not permit Waltra to use the apartment unit in the second building as office space, nor did it permit Waltra's tenant, Wick Homes, Inc., to use the basement office space in the first building. The agreements provided that, unless Farmers Home Administration gave it prior consent, Waltra could not use the housing for any purpose other than rental-housing for eligible occupants. Waltra acted without Farmers Home Administration's prior approval. The conversion of space in the second building to an apartment (unit 21) was also done without prior consent. In addition, apartment 21 did not meet the requirements of the Department of Housing and Urban Development or comply with state and local building codes. Waltra also violated the loan agreement by excluding in their financial reports the rental income received for the basement office space. The Wisconsin State Director of Farmers Home Administration has required Waltra to remodel apartment 21 so that it will meet government standards, and has retained a certified public accountant to audit Waltra's financial records for the 1972-1976 period. (LDM)

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MAR 11 1977

The Honorable Les Aspin
House of Representatives

Dear Mr. Aspin:

In your September 16, 1976, letter, you requested that we review the legality and propriety of a decision by Farmers Home Administration, Department of Agriculture, to permit a commercial business to convert into office space, apartment units built in Mazomanie, Wis. for senior citizens and families of low and moderate incomes. Farmers Home Administration financed the apartment units under sections 515 and 521 of the Housing Act of 1949, as amended. You also asked us to determine whether a specific apartment unit in one of the buildings was safe and liveable and why Farmers Home Administration did not know that the unit existed.

In October 1968 and April 1970, Farmers Home Administration approved two rural rental-housing loans of \$85,000 and \$109,000 respectively, for Messrs. John Trager and Merton Walters, business partners in the Waltra Corporation, Mazomanie, Wis. The loans were for construction costs of two apartment buildings in Mazomanie for senior citizens and families of low and moderate income.

The first two-story apartment building had eight units and a full basement. Waltra converted part of the basement into office space for its own use, but later leased the space to Wick Homes, Inc., Mazomanie, Wis. from August 1972 to November 1976.

A second two-story apartment building had ten units, including two complete units in the basement plus a partial basement, a portion of which Waltra converted into an apartment unit without Farmers Home Administration's approval, as required. Also Waltra leased an apartment unit on the second floor in the building to Wick Homes from February to September 1976 because, according to Waltra, the unit was damaged by a previous tenant and was difficult to rent. A new tenant sublet the unit to Wick Homes from September to November 1976.

The loan agreements between Farmers Home Administration and Waltra did not permit Waltra to use the apartment unit in the second building as office space, nor did it permit Wick Homes to use the basement office space in the first building. The agreements provided that, unless Farmers Home Administration gave prior consent, Waltra could not use the housing for any purpose other than rental-housing or related facilities for eligible occupants. Waltra acted without Farmers Home Administration's prior approval.

The partial basement area in the second building that was converted into apartment unit no. 21 did not meet the requirements of Department of Housing and Urban Development minimum property standards nor of the State and local building codes, as Farmers Home Administration regulates as required-- the units lacked the proper size windows necessary for health and safety reasons. As a result of our review, proper size windows are being installed.

Also converting the partial basement space into apartment unit no. 21 violated a provision of the loan agreement that prohibited Waltra from entering into any contract or agreement for improvements or extensions to the housing or other property securing the loan agreement, without Farmers Home Administration's prior approval. Farmers Home Administration was unaware of the apartment unit because Waltra used their own money to convert the space and did not report to Farmers Home Administration the work or rental income from the unit-- about \$4,700 received between January 1973 and November 1976. Waltra violated the loan agreement by not reporting the income.

During our review we found that Waltra also violated the loan agreement by excluding in their financial reports to Farmers Home Administration rental income of \$21,800 from the basement office space, received between August 1972 and September 1976. After we told Farmers Home Administration of these violations, the Wisconsin State director requested Waltra to retain a certified public accountant to audit the apartment income and expense records for the years 1972 to 1976.

At your request, we did not obtain Farmers Home Administration's comments on this report. We have informally discussed our findings with the Wisconsin State officials of

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Farmers Home Administration who, as discussed in the report, requested that Waltra Corporation (1) retain a certified public accountant to audit the accuracy of the corporate financial records during the period Wick Homes rented space in the apartment buildings and (2) replace the windows in the basement apartment units.

A detailed summary of our findings is enclosed.

Sincerely yours,

ACTING Comptroller General
of the United States

Enclosure

SUMMARY OF INQUIRY INTO
THE USE OF APARTMENT BUILDINGS
FINANCED BY FARMERS HOME ADMINISTRATION

Congressman Les Aspin asked GAO to inquire into the legality and propriety of a decision by Farmers Home Administration, Department of Agriculture, to permit a commercial business to convert into office space apartment units built in Mazomanie, Wis., for senior citizens and families of low and moderate incomes. Farmers Home Administration financed the apartment units under sections 515 and 521 of the Housing Act of 1949, as amended. In addition, Congressman Aspin asked GAO to determine whether a specific apartment unit in one of the buildings was safe and liveable and why Farmers Home Administration did not know that the unit existed.

BACKGROUND

In October 1968 and April 1970, Messrs. John Trager and Merton Walters, business partners in the Waltra Corporation, obtained two rural rental-housing loans for \$85,000 and \$109,000, respectively. The loans were for construction costs of two apartment buildings in Mazomanie, Wis. for senior citizens and families of low and moderate income. The first two-story apartment, building 1, had eight units and a full basement. The second two-story apartment, building 2, had 10 units, including two basement apartment units, plus a partial basement.

The basement in building 1 was converted into office space for Waltra's own use but was later leased to Wick Homes, Inc. from August 1972 to November 1976. Apartment no. 17 located in building 2 was rented for commercial use to Wick Homes from February to September 1976 without the knowledge or approval of Farmers Home Administration. The partial basement in building 2 was converted into an apartment unit, no. 21, without Farmers Home Administration's approval, and leased to senior citizens from January 1973 to the present time.

THE LEGALITY AND PROPRIETY OF THE USE OF APARTMENTS FOR COMMERCIAL OFFICE SPACE

Waltra violated the loan agreements by renting the converted office in building 1 and apartment no. 17 to Wick without Farmer's Home Administration's approval. The loan

agreements provide that, unless Farmers Home Administration gives prior consent, Waltra cannot use the housing for any purpose other than rental-housing or related facilities for eligible occupants. Also Waltra cannot without prior approval enter into any contract or agreement for improvements or extensions to the housing or other property securing the loan agreements. However, since Waltra renovated the basement with its own funds, the commercial tenant was occupying the basement space, and other tenants were not inconvenienced, Farmers Home Administration approved the occupancy after the fact. Farmers Home Administration officials said they had not been aware of the commercial use of apartment no. 17.

Farmers Home Administration officials also said that the rent received for a portion of the basement used for commercial purposes is used to defer some of the housing operating costs, therefore, keeping rent for the other tenants lower.

This statement is not entirely correct since the rental income was not reported in the financial records of the building, as required by the loan agreements.

Basement office space

When building 1 was constructed, there was no intended use for most of the basement. A laundry room, a furnace room, a bathroom, and an individual caged area for tenant storage occupied about 30 percent of the basement; the rest was open space. The owners decided to build an office in the basement for apartment management. Farmers Home Administration approved this and the office was constructed. Half the basement remained vacant.

The owners decided later they did not need this office space, and enlarged the office and leased it to Wick in August 1972. The lease provided that the right of the lessee to occupy the premises after September 1, 1973, was up to the discretion of the lessors and would be judged by the impact of Wick's occupancy on the contentment of the apartment occupants on a continuing basis.

The new office space was improved with the owners' funds at a cost of \$6,138.85. Waltra did not obtain Farmers Home Administration's approval to improve the space or lease it to Wick, as the loan agreement required. Wick paid one thirty-sixth of the improvement cost plus 1 percent interest

each month on the improvements for 3 years. In addition, a base rent of \$284 (later changed to \$279) was paid for the space. Wick stayed until November 1, 1976.

In mid October 1972, the Farmers Home Administration county office discovered, while making a compliance review of the apartments, that the basement of building 1 was being used commercially and informed the Farmer Home Administration State office. The State office responded on October 31, 1972, that

"We are well aware of this occupancy. It has been discussed and viewed by representatives of our National Office. Under the circumstances, it is not deemed necessary to take any action relative to this matter."

We were not able to determine precisely when the Wisconsin State office became aware of the situation. Farmers Home Administration officials in Washington had no record of discussing Wick's occupancy with the Wisconsin office before October 1972. Mr. Trager said that he did not ask permission from Farmers Home Administration to rent the office space to Wick.

Tenants in the building said they had not been inconvenienced by Wick. In fact, several of them wished Wick was back because the personnel had provided companionship to them.

The owners would, of course, like to rent the basement office space again. Farmers Home Administration State officials told them they would have to receive approval from officials in Washington, D.C.

Commercial use of apartment no. 17

Apartment no. 17 is on the second floor of building 2. On August 1, 1974, a blind man moved in. He later received a seeing-eye dog and vacated on July 31, 1975, on his own accord. The dog urinated on the rug, mainly in one area by the door. The rug was professionally cleaned, but the odor remained, since it had apparently reached the wood floor under the rug.

On September 1, 1975, a different tenant moved into the apartment with a 1-year lease. The lease contained no provision on an odor problem. However, during the first night the tenant complained and subsequently was informed he could move out if the odor became unbearable. On December 12, 1975, he vacated because of the odor.

We were informed that the carpet was cleaned again and dishes filled with ammonia were set around the room in an attempt to remove the odor. The owners did little to rent the unit to a private person then. Due to the odor and the small town's knowledge of the odor, the owners wanted a commercial renter to serve as a buffer for a short period until the odor dissipated. Therefore, Wick rented the apartment in February 1976 at \$145 a month. The agreement required Wick to vacate by September 1, 1976, and to be compatible with the other occupants.

A new tenant leased the unit in September 1976. Since he did not need the apartment immediately, he sublet to Wick until November 1, 1976. Wick vacated before the deadline.

According to Wick personnel who worked in the apartment, the odor decreased and finally disappeared. When the new tenant moved in there was no dog-related odor.

Tenants in building 2 told us Wick personnel made noise, but it was not bothersome.

Apparently Farmers Home Administration officials did not know that Wick was using apartment no. 17 until Congressman Aspin's office called in September 1976 and Farmers Home Administration investigated.

THE HEALTH AND SAFETY FEATURES OF THE BASEMENT APARTMENT NO. 21

Apartment no. 21 did not meet the requirements of Department of Housing and Urban Development's minimum property standards or of the State and local building codes. The major problem was lack of adequate window area for health and safety reasons. The occupant has vacated and remodeling to bring the apartment into compliance has begun. Farmers Home Administration was not aware of this apartment because

--Permission had not been requested from Farmers Home Administration for its construction.

--It had been constructed with private funds.

--Rental income had not been reported to Farmers Home Administration.

The owners renovated basement space in building 2 for office space. However, a commercial user could not be located, so the space was converted to a one-bedroom apartment, no. 21, with owners' funds.

A tenant occupied the apartment on January 15, 1973, and later moved out. The apartment was vacant for a short period until another tenant occupied it on December 1, 1973.

On December 2, 1976, we inspected apartment no. 21. The unit had only one door and two very small high windows--too small for exiting or entering. We believe that the unit would not have passed a health and safety inspection.

At our request a Farmers Home Administration employee inspected the unit on December 3, 1976, and found that the unit did not meet Department of Housing and Urban Development minimum property standards or State and local building code requirements, as Farmers Home Administration regulations required. As a result, the tenant vacated on December 3, and remodeling to bring the apartment into compliance has begun.

INCOMPLETE AND INACCURATE FINANCIAL REPORTS

Waltra Corporation did not include in its financial reports to Farmers Home Administration income totaling about \$26,500 or obtain Farmers Home Administration approval to use the funds, as required by the loan agreement. About \$21,800 was received from Wick, between August 1972 and September 1976, for use of the basement in building 1 and about \$4,700 received from tenants of apartment no. 21 in building 2 between January 1973 and November 1976.

Section 5 of the loan agreement states that all income and revenue from the housing shall upon receipt be immediately deposited in the general fund account. Various expenses are paid from this account, and section 8 of the loan agreement requires that any balance in the account should be transferred to a reserve account. With prior consent of the Government, the borrower may use funds over a required reserve for several purposes, including, under certain conditions, any purpose desired by the borrower.

According to a Farmers Home Administration official, Waltra established the required reserve. Therefore, if the \$26,500 had been reported properly, Farmers Home Administration would probably have given approval for its withdrawal.

Also Waltra's financial reports to Farmers Home Administration for 1973 and 1975 show 10 percent of income as a reduction to income for vacancy and nonpayment of rents for both the year covered and the budget year. This procedure is correct for budget purposes; however, actual losses, which amounted to almost zero, should have been reported for the actual year covered. Financial reports for 1974 were not prepared.

After we told Farmers Home Administration of Waltra's violations, the Wisconsin State directed requested Waltra to retain a certified public accountant to audit the apartment income and expense records for the years 1972 to 1976.